

DEPARTMENT OF STATE REVENUE

**LETTER OF FINDINGS NUMBER: 00-0233
SALES AND USE TAX
FOR TAX PERIODS: 1995-1997**

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1. Sales and Use Tax: Unloaders

Authority: IC 6-2.5-3-2 (a), IC 6-2.5-5-3 (b), 45 IAC 2.2-5-8 (c), . Indiana Bell Telephone Co. v. Indiana Department of Revenue, 627 N.E. 2d 1386, Ind. Tax Court (1994).

Taxpayer protests the imposition of use tax on unloaders.

2. Sales and Use Tax: Scissors Lifts and Pallet Lifts

Authority: IC 6-2.5-5-3 (b), 45 IAC 2.2-5-8 (c) (2) (F), Indiana Department of Revenue v. United States Steel, 425 N.E. 2d, 659, Ind. App. (1981).

Taxpayer protests the imposition of use tax on scissors lifts and pallet lifts.

3. Sales and Use Tax: Stretch Wrap

Authority: IC 6-2.5-5-9 (d), 45 IAC 2.2-5-16 (c).

Taxpayer protests the imposition of use tax on stretch wrap.

4. Sales and Use Tax: Materials Purchased by Contractors

Authority: IC 6-2.5-2-1, IC 6-2.5-3-2 (a), IC 6-2.5-2-1 (b), IC 6-2.5-4-1 (b), 45 IAC 2.2-4-22.

Taxpayer protests the imposition of use tax on materials purchased by contractors.

5. Tax Administration: Penalty

Authority: IC 6-8.1-10-2.1, 45 IAC 15-11-2(b).

Taxpayer protests the imposition of the penalty.

Statement of Facts

The taxpayer is a corporation that produces toothpaste, cleanser and base material in Indiana. The base material is placed in containers and shipped to other facilities for completion. During the early portion of the audit, the taxpayer also produced shaving cream. After a routine audit, the Indiana Department of Revenue assessed additional sales and use tax, interest and penalty. The taxpayer protested the assessment and a hearing was held.

1. Sales and Use Tax:. Unloaders

Discussion

Pursuant to IC 6-2.5-3-2 (a), Indiana imposes an excise tax on tangible personal property stored, used or consumed in Indiana. There are several statutory exemptions from the use tax. It is established law that all tax exemptions must be strictly construed against taxpayers. Indiana Bell Telephone Co. v. Indiana Department of Revenue, 627 N.E. 2d 1386, Ind. Tax Court (1994). Therefore, the taxpayer bears the burden of showing that any item meets the tests to qualify for exemption.

The taxpayer contends that the tube unloader qualifies for exemption from the use tax pursuant to the following provisions of IC 6-2.5-5-3 (b):

Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.

This exemption is clarified at 45 IAC 2.2-5-8 (c):

The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.

The first items that the taxpayer contends qualifies for exemption as directly used in direct production are the tube unloaders. Empty toothpaste tubes are moved from the warehouse to the production line on a conveyer belt that the taxpayer agrees is subject to use tax. The tube unloaders move the empty toothpaste tubes from the conveyer belt to the point where they are filled with toothpaste. The process of moving the tubes to the point where the production process begins is not a use that has an immediate effect on the production of toothpaste. This use does not qualify for exemption.

Finding

Taxpayer's protest is denied.

2. Sales and Use Tax: Scissors Lifts and Pallet Lifts

Discussion

The taxpayer's second point of protest concerns the assessment of use tax on the scissors lifts and pallet lifts which are used to raise and lower the pallets to facilitate the loading of finished product onto the pallets prior to shipping. The scissors and pallet lifts raise and lower the pallets to levels that are a safe working height for the workers who hand stack the pallets. Therefore, the taxpayer contends that these lifts qualify for the directly used in direct production exemption as safety equipment. IC 6-2.5-5-3 (b).

In support of its position, the taxpayer cites Indiana Department of Revenue v. U.S. Steel, 425 N.E.2d 659, Ind. App. (1981). In that case, the Court held that personal safety equipment used by U.S. Steel workers qualified for the directly used in direct production exemption as safety equipment. The exempt equipment included items such as safety eyeglasses, protective mittens, hardhats, goggles masks, hoods, heatshields, respirators and protective clothing. Without these personal safety items, the workers would not have been able to withstand the dangers of the environment and could not have produced the steel. The items that qualified for exemption were essential to the steel production. They were not merely items to make the work place more comfortable or convenient for the employees as in the case of the taxpayer's pallet lifts and scissors lifts.

45 IAC 2.2-5-8 (c)(2)(F) provides an exemption for "safety clothing or equipment which is required to allow a worker to participate in the production process without injury or to prevent contamination of the product during production." The scissors lifts and pallet lifts do not meet this regulatory test. They make it more convenient and comfortable for the workers to hand stack the pallets. They are not, however, necessary for a worker to stack the pallets. Therefore, they do not qualify for the safety equipment exemption to the use tax.

Finding

Taxpayer's protest is denied.

3. Sales and Use Tax: Stretch Wrap

Discussion

The taxpayer purchases stretch wrap that it uses in the packaging of its product. Specifically, the stretch wrap is used to wrap pallets of boxes of product for shipment to distribution warehouses. At these warehouses the stretch wrap is sometimes taken off the palletized product and the product is reorganized and re-shrink wrapped for smaller shipments. The audit assessed use tax on the twenty five per cent (25 %) of the stretch wrap that was replaced in this manner. The taxpayer protests this assessment.

The taxpayer contends that this stretch wrap qualifies for exemption pursuant to IC 6-2.5-5-9 (d) as follows:

Sales of wrapping material and empty containers are exempt from the state gross retail tax if the person acquiring the material or containers acquires them for use as nonreturnable packages for selling the contents that he adds.

45 IAC 2.2-5-16 (c) further clarifies this exemption as follows:

General rule. The receipt from a sale by a retail merchant of the following types of tangible personal property are exempt from state gross retail tax:

(1) Nonreturnable containers and wrapping materials including steel strap and shipping pallets to be used by the purchaser as enclosures for selling tangible personal property.

. . . .

(d) Application of general rule.

(1) Nonreturnable wrapping material and empty containers. To qualify for this exemption, nonreturnable wrapping materials and empty containers must be used by the purchaser in the following way:
(A) The purchaser must add contents to the containers purchased; and
(B) The purchaser must sell the contents added.

In this case, the taxpayer purchases shrink wrap, a nonreturnable wrapping material. The taxpayer wraps pallets containing tubes of toothpaste in the shrink wrap. The taxpayer then delivers the toothpaste to distribution centers where part of the shrink wrap is removed and the toothpaste is rewrapped. The taxpayer contends that this rewrapping always takes place after the toothpaste is sold to distribution centers that are not related to the taxpayer. The taxpayer did not, however, submit any evidence to substantiate its position that the

distribution centers and warehouses are not owned or operated by the taxpayer and that the packages are rewrapped after the sale is consummated.

Finding

The taxpayer's protest is denied.

4. Sales and Use Tax: Materials Purchased by Contractors

Indiana imposes a sales tax on retail transactions made in Indiana. IC 6-2.5-2-1. A retail transaction takes place when a retailer acquires tangible personal property and transfers it for a consideration in his ordinary course of business. IC 6-2.5-4-1 (b). The purchaser of the tangible personal property in a retail transaction pays the tax to the seller as an agent for the state. IC 6-2.5-2-1 (b).

A purchaser who acquires tangible personal property in a retail transaction without paying the sales tax is liable for the use tax when the purchaser uses the tangible personal property in Indiana. IC 6-2.5-3-2 (a).

The application of the general rules to contractors is stated at 45 IAC 2.2-4-22 as follows:

- (a) A contractor may purchase construction material exempt from the state gross retail tax only if he issues either an exemption certificate or a direct pay certificate to the seller at the time of the purchase.

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- (e) Disposition subject to the use tax. With respect to construction material a contractor acquired tax-free, the contractor is liable for the use tax and must remit such tax (measured on the purchase price) to the Department of revenue when he disposes of such property in the following matter.

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- (3) Lump sum contract. He converts the construction material into realty on land he does not own pursuant to a contract that includes all elements of cost in the total price.

The audit assessed additional tax on the materials portion of several invoices which the taxpayer claims were actually lump sum contracts and the contractors bear the responsibility for paying the sales or use tax. To substantiate its contention, the taxpayer submitted documentation for each of the contractors. That documentation included schedules of the invoices from each vendor, copies of the invoices, written assertions from most of the contractors indicating that the contractors deemed themselves to be entering into a lump sum contract with the taxpayer and that sales taxes were either paid at the time of purchase or use taxes were paid when the materials were removed from tax-free inventory for use. The documentation presented

sustains the taxpayer's burden of proving that it is not responsible for the sales or use tax on the lump sum contracts.

Finding

The taxpayer's protest is sustained subject to audit verification.

5. Tax Administration: Penalty

Discussion

Taxpayer's final point of protest concerns the imposition of the ten per cent negligence penalty pursuant to IC 6-8.1-10-2.1. Indiana Regulation 45 IAC 15-11-2 (b) clarifies the standard for the imposition of the negligence penalty as follows:

"Negligence", on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence.

The audit assessed use tax on purchases in addition to those under protest. For example, the taxpayer failed to pay retail sales tax or remit use tax on the rental of forklifts and non-production computer equipment. The taxpayer's actions meet the requisite negligence standard.

Finding

Taxpayer's final point of protest is denied.

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